

Message Text

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C O N F I D E N T I A L SECTION 01 OF 04 PARIS 30291

USEEC

PARIS PASS OECD

LIMDIS GREENBACK

E. O. 11652: GDS

TAGS: EFIN

SUBJECT: EMS -- A CURRENT FRENCH POINT OF VIEW

REF: (A) BONN 15754, (B) STATE 223934, (C) PARIS 24285

SUMMARY

FROM THE FRENCH POINT OF VIEW SOME OF THE TECHNICAL
ISSUES HAVE BEEN CLEARED AWAY BY THE EC WORKING
COMMITTEE, BUT IMPORTANT DIFFERENCES WITH GERMANY
REMAIN--PARTICULARLY ON THE NATURE OF THE EXCHANGE
RELATIONSHIP WITHIN EMS. THE BALL HAS NOW BEEN
PASSED TO GISCARD AND SCHMIDT AT THEIR SEPTEMBER 14-15
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SUMMIT TO MOVE THE AGREEMENT AHEAD. NOTHING OF
IMPORTANCE WAS LEARNED ON THE ISSUES THAT CONCERN
THE U.S. DIRECTLY--I.E., DOLLAR INTERVENTION POLICY,
THE POSSIBLE DEFLATIONARY BIAS OF THE SYSTEM AND
THE RELATIONSHIP WITH THE IMF.
END SUMMARY

1. THE TREASURY REPRESENTATIVE REVIEWED ON SEPTEMBER 11 WITH BACQUIAST, DIRECTOR OF MULTILATERAL AFFAIRS IN THE TREASURY, THE EXTENT TO WHICH THE TECHNICAL PROBLEMS OF CONVERTING EMS HAD BEEN MASTERED AND OPTIONS PREPARED FOR THE FINANCE MINISTERS OPERATIONAL SCHEME. BACQUIAST BEGAN BY REVIEWING THE WORK OF THE THREE COMMITTEES. THAT OF THE POLITICAL ECONOMY COMMITTEE, WHERE THE QUESTIONS RELATING TO THE TRANSFER OF RESOURCES THROUGH EXISTING COMMUNITY MECHANISMS ARE BEING DISCUSSED, HE CLEARLY REGARDED AS THE PLACE WHERE THE PRICE TO BE PAID BY THE FINANCIALLY STRONGER MEMBERS TO THE WEAKER ONES FOR THEIR ACQUIESCENCE TO EMS WAS BEING CONSIDERED. BUT ONLY THE HEADS OF STATE, NOT THE TECHNICIANS, COULD MAKE DECISIONS OR EVEN PROPOSE OPTIONS IN THIS AREA. HE EXPECTED NO WRITTEN REPORT BEFORE DECEMBER.

2. HE FELT THAT THE CENTRAL BANK GOVERNORS' REPORT WAS TOO TECHNICAL TO BE CLEAR TO THE MINISTERS AND PROBABLY TOO CAUTIOUS IN MAKING RECOMMENDATIONS. ITS MAIN CONCLUSIONS, HOWEVER, WERE COMPATIBLE WITH THOSE OF THE MONETARY COMMITTEE.

3. BACQUIAST SUMMARIZED THAT COMMITTEE'S RESULTS UNDER THE VARIOUS HEADINGS LISTED BELOW. BECAUSE THE ACCOUNT AVOIDED ALMOST COMPLETELY ANY DIFFERENCES OF OPINION
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EXCEPT ON THE QUESTION OF HOW MEMBER CURRENCIES WOULD RELATE TO ONE ANOTHER, IT MUST BE REGARDED AS A MIXTURE OF GENUINE CONSENSUS AT THE EXPERT LEVEL WITH THE FRENCH VIEW OF THE MOST DESIRABLE AND/OR LIKELY FINAL POSITION WHERE DIVERGENCES OF VIEW EXIST.

4. THE NUMERAIRE OF THE SYSTEM AND INTERVENTION RULES

HE THOUGHT THAT THE DIFFERENT INITIAL APPROACHES-- BASKET VERSUS PARITY GRID--WOULD MERGE INTO A COMPROMISE. IT WOULD BE "A FIXED BUT ADJUSTABLE BASKET" WITH INTERVENTION RULES DERIVED FROM CURRENT PRACTICE IN THE SNAKE. IT WOULD ALSO HAVE BUILT-IN SAFEGUARDS WHICH WOULD LIMIT THE EXTENT TO WHICH ONE CURRENCY COULD HAVE THE DOMINANT WEIGHT IN THE ECU. INTERVENTION WOULD BE IN COMMUNITY CURRENCIES BUT OPERATIONS IN DOLLARS ARE NOT EXCLUDED. INTERVENTION VIS-A-VIS THE DOLLAR WAS NOT DISCUSSED. THE COSTS OF INTERVENTION WOULD BE SHARED IN VARIOUS WAYS. THE EXAMPLES HE SUGGESTED WERE DELAYED SETTLEMENT OF CLAIMS OR CREDITS AT LOW INTEREST RATES.

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5. COMMENT: BACQUIAST WAS VAGUE IN THIS MOST IMPORTANT OF AREAS, PRESUMABLY BECAUSE THERE IS A WIDE AREA OF DISAGREEMENT. THE FOLLOWING IS A POSSIBLE INTERPRETATION OF WHAT HIS STATEMENT MEANS. A FLOATING BASKET IN CONTRAST TO A PARITY GRID: (A) MAKES IT VERY DIFFICULT TO CALCULATE INTERVENTION POINTS; (B) ALLOWS MUCH MORE DIVERGENCE BETWEEN MEMBER CURRENCIES TO TAKE PLACE; (C) LEAVES OPEN THE POSSIBILITY OF ONE CURRENCY BEING AT THE TOP OF THE INTERVENTION BAND WITH NOBODY ON THE BOTTOM, AND (D) COULD LEAD TO ONE MONEY DOMINATING THE BASKET IF IT APPRECIATED FOR A LONG PERIOD WITH RESPECT TO THE OTHERS.

6. ACCORDING TO BURGEAD, THE EC INTERNATIONAL FINANCE EXPERT WHO WAS IN PARIS FOR THE G-10 MEETING, AN ECU WHICH IS BASED ON THE CURRENT MARKET RATES OF EACH OF ITS COMPONENT CURRENCIES, AND WHICH WOULD SERVE
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AS THE "CENTRAL RATE" IN RELATION TO WHICH EACH MEMBER'S INTERVENTION MARGINS ARE CALCULATED, WOULD REQUIRE THE CENTRAL BANKS AND MARKET PARTICIPANTS TO OPERATE COMPUTERS CONTINUOUSLY TO DETERMINE WHERE THE INTERVENTION POINTS WERE. THE SOLUTION APPARENTLY BEING DISCUSSED WOULD BE TO FREEZE THE ECU FOR PERIODS OF TIME AT CERTAIN MARKET RATES. IN EFFECT, THE CENTRAL BANKS WOULD FIX THEIR RELATIONSHIP TO ONE ANOTHER FOR A DAY OR A WEEK OR WHATEVER PERIOD THEY WISHED. IF MAINTAINED FOR INDEFINITE PERIOD IT WOULD GIVE THEM THE SAME CONNECTION TO EACH OTHER AS THEY HAVE IN THE SNAKE EXCEPT THAT IT WOULD BE EXPRESSED THROUGH THE ECU RATHER THAN DIRECTLY BETWEEN CURRENCIES.

7. MORE IMPORTANTLY, FIXING THE VALUE OF THE ECU TEMPORARILY MAY BE A POLICY COMPROMISE BETWEEN THE FRENCH (AND ITALIANS AND BRITISH) WITH THE GERMANS IN THE SENSE THAT SPECULATIVE WAVES FROM THE DOLLAR TO DEUTSCHMARK WILL BE FELT MUCH MORE QUICKLY IN THE OTHER MEMBER COUNTRIES THAN THEY WOULD BE SOFTENED BY THE INTERMEDIARY OF A FLOATING ECU. THE EMS WOULD THEN OPERATE THE WAY THE SNAKE DOES NOW FOR PERIODS OF TIME BUT WOULD DIFFER BY PERIODICALLY REALIGNING ALL THE CURRENCIES BY RECALCULATING THE VALUE OF THE ECU IN TERMS OF THE DOLLAR VALUE OF EACH COMPONENT CURRENCY. THE INTERVENTION RULES MIGHT FOLLOW SNAKE PRACTICE AT LEAST PART OF THE TIME--I.E., THE WEAKEST CURRENCY MUST ALWAYS INTERVENE IN ITS OWN BEHALF AND THUS THE GERMANS WOULD NEVER BE ALONE AT THE TOP. END COMMENT.

8. THE EUROPEAN FUND

IN CONTRAST TO THE AMBIGUITY OF BACQUIAST'S
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STATEMENTS ON THE NUMERAIRE, HE GAVE THE DEFINITE IMPRESSION THAT THE MAIN OUTLINES OF THE EUROPEAN FUND HAD BEEN AGREED. THERE WOULD BE TWO ACCOUNTS. THE FIRST WOULD BE CREATED BY THE DEPOSIT OF GOLD AND FOREIGN EXCHANGE EQUAL TO 20 PERCENT OF RESERVES WHICH HE ESTIMATED TO BE ABOUT \$35 BILLION. THESE ASSETS WOULD BE "FROZEN". ECUS WOULD BE ISSUED TO EACH CENTRAL BANK ON THE BASIS OF THEIR CONTRIBUTIONS. THEY COULD BE TRANSFERRED BETWEEN CENTRAL BANKS AS A MEANS OF SETTLEMENT OR CONVERTED INTO NATIONAL MONEY TO PROVIDE INTERVENTION CURRENCY. GOLD WOULD PROBABLY BE VALUED IN RELATION TO ITS MARKET PRICE.

9. THE SECOND ACCOUNT WOULD BE DERIVED FROM NATIONAL CURRENCIES AND ALSO EQUAL TO 20 PERCENT OF RESERVES. ITS PURPOSE WAS TO PROVIDE CREDIT TO COMBAT SPECULATIVE ATTACKS WHICH DISRUPTED CURRENCY RELATIONSHIPS BETWEEN MEMBERS. THERE WOULD BE NO PRE-DEFINED COUNTRY LIMITS FOR LOANS WITH REPAYMENT PERIODS UP TO ONE YEAR. THEY WANTED TO BE IN A POSITION TO CONCENTRATE THEIR RESOURCES WHEREVER THE COMMUNITY WAS THREATENED. PART OF THE CREDIT COULD BE USED FOR LONGER TERM BALANCE-OF-PAYMENTS CREDIT (UP TO FIVE YEARS) SUBJECT TO CONDITIONALITY.

10. PARITY CHANGES WITHIN THE SYSTEM

CHANGES WOULD HAVE TO OCCUR FROM TIME TO TIME. THEY WOULD BE THE ONLY WAY OF DEALING WITH LONGER TERM DISEQUILIBRIA BETWEEN MEMBERS. THEY WANTED TO BE PARTICULARLY CAREFUL IN NOT DELAYING ADJUSTMENT BY PROVIDING TOO MUCH CREDIT. HE REJECTED HIS EARLIER

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IDEA THAT THE BEST TECHNIQUE WOULD BE SMALL BUT
FREQUENT ADJUSTMENTS BY THE COMMENT "THAT THE CRAWLING

PEG WAS A MEANS OF CONTROLLING FLOATING BUT THEIR
OBJECTIVE (WITHIN THE EMS) WAS FIXED RATES."
DEVALUATION WOULD HAVE TO BE FOR WHATEVER SIZE
WAS NECESSARY TO CORRECT FUNDAMENTAL DISEQUILIBRIA.

11. THE DEFLATIONARY OR INFLATIONARY BIAS OF THE SYSTEM

THIS IDEA HAD BEEN DISCUSSED BECAUSE OF BRITISH AND
ITALIAN WORRIES. HE SAW IT AS BASICALLY A
POLITICAL ISSUE TO BE SETTLED BY THE HEADS OF GOVERN-
MENTS THUGH AGREEING TO THE OBSERVATION THAT THE
CHOICE OF NUMERAIRE AND INTERVENTION RULES WOULD
CERTAINLY HAVE AN INFLUENCE.

12. TYPES OF LIQUIDITY

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IN RESPONSE TO A QUESTION, BACQUIAST DEFINED THE
DIFFERENCES BETWEEN THE FRENCH POSITION ON EACH TYPE
OF INTERNATIONAL LIQUIDITY AS FOLLOWS:

(A) THE SDRS WERE IN A SEPARATE CATEGORY BECAUSE
THEY WERE UNCONDITIONAL LIQUIDITY; WITH RESPECT TO
CONDITIONAL LIQUIDITY,
(B) THE WILLINGNESS TO AGREE TO A 50 PERCENT INCREASE
IN IMF QUOTAS IN THE NEXT ROUND RESPONDED TO THE
EXPECTED BALANCE-OF-PAYMENTS NEEDS OF THE LDCS;
(C) THE SUPPORT FOR A LARGE GAB WAS TO PROVIDE FOR
THE ITALIANS AND THE UK IN THE EVENT THEY MIGHT NEED
BALANCE-OF-PAYMENTS CREDITS; AND,
(D) THE EUROPEAN FUND CREDIT WAS A DEVICE TO FIGHT
SPECULATORS. THEY WANTED TO MAKE SURE THAT SOME
FINGERS GOT BURNED IF THEIR CURRENCIES WERE
MANIPULATED. HE STATED, SOMEWHAT DEFENSIVELY, THAT
IT WAS NOT FRANCE'S INTENTION TO BORROW BUT THE NEED
TO HAVE "DETERRENTS" AROUND THAT MOTIVATED THEIR VIEWS.
IN ANY CASE, FRANCE WOULD NOT BORROW FROM THE IMF
"FOR WELL-KNOWN REASONS".

13. THE TIMING OF THE DECISION MAKING

HE THOUGHT THAT THE TECHNICAL WORK HAS NOW REACHED
THE POINT WHERE DECISIONS AT THE POLITICAL LEVEL
COULD BE REACHED. "IF THE MEETING BETWEEN GISCARD
AND SCHMIDT CANNOT SOLVE THE DIFFERENCES, THEN
PERHAPS THE EEC MINISTERS ON THE 18TH OR LATER MEETINGS
WILL. IF THERE IS AN AGREEMENT, IT WILL BE REACHED BY
DECEMBER."

CONCLUSIONS
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14. IN THE COURSE OF SIX WEEKS' INTENSIVE STAFF
WORK/NEGOTIATIONS, THE DIFFERENCES BETWEEN THE PRESENT
SNAKE COUNTRIES LED BY GERMANY AND THE PROPOSED NEW
MEMBERS HAVE SHOWN UP FAIRLY QUICKLY. IN PRACTICE,
FRENCH INTERESTS ARE MUCH CLOSER TO THOSE OF THE
BRITISH AND ITALIANS THAN OF GERMANY. ALL THREE (PLUS
IRELAND) ARE INTERESTED IN FLEXIBLE ARRANGMENTS WHICH
WOULD REDUCE THE POSSIBILITY THAT THE EMS WOULD SIMPLY
BECOME A DEUTSCHMARK BLOC WITH ALL PARTICIPANTS COMING

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TO ALIGN THEIR FINANCIAL POLICIES CLOSELY AND CONTINU-
OUSLY ON THOSE OF GERMANY. THUS THEY WANT AN ECU
BASKET AND SUBSTANTIAL CREDITS WHILE GERMANY
APPARENTLY PREFERS TO HAVE CURRENCIES DEFINED IN

RELATION TO ONE ANOTHER AND PERHAPS LESS CREDIT. THE FRENCH SEEMED TO HAVE MOVED CLOSER TO THE GERMAN POSITION ON THE NUMERAIRE WHILE REMAINING FIRM ON THE BREMEN ANNEX IN THE MATTER OF CREDIT. THEY HAVE ALSO STOPPED TALKING ABOUT SMALL INTRA-EUROPEAN PARITY ADJUSTMENTS AND NOW SUPPORT MORE SUBSTANTIAL ONES WHENEVER NECESSARY, WHICH MAY BE A CONCESSION TO GERMAN FEARS OF CREDIT BEING USED TO DELAY DEVALUATIONS. WHAT IS NOT CLEAR IS THE EXTENT TO WHICH THE GERMANS ARE PREPARED TO MODIFY THEIR VIEWS.

15. THESE DIFFERENCES WOULD NOW BE RAISED TO THE HEADS OF STATE LEVEL AT THE AIX-LA-CHAPELLE MEETING
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BETWEEN GISCARD AND SCHMIDT ON SEPTEMBER 14-15. IN PREPARATION, GISCARD PUBLICLY CALLED CLAPPIER (GOVERNOR OF THE BANK OF FRANCE) TO THE ELYSEE ON SEPTEMBER 6 FOR A REPORT AND THEN SENT HIM WITH SOME FANFARE TO TALK TO PANDOLFI IN BEGAMO ON SEPTEMBER 8. HE WILL ACCOMPANY GISCARD WHO SEEMS TO BE PLACING HIMSELF IN A POSITION WHERE SOME MEASURE OF AGREEMENT WITH SCHMIDT WILL BE NECESSARY TO AVOID POLITICAL EMBARRASMENTS.

16. ON ISSUES OF DIRECT CONCERN TO THE U.S., THE FRENCH REMAIN VERY VAGUE ABOUT THE FAMOUS COORDINATED INTERVENTION VIS-A-VIS THE DOLLAR, WHETHER THE SYSTEM WILL HAVE A DEFLATIONARY OR INFLATIONARY BIAS AND THE LONGER TERM RELATIONSHIP TO THE IMF.
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